

## Message Text

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TO SECSTATE WASHDC IMMEDIATE 4984

INFO USDOC WASHDC

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 3623

E.O. 11652 GDS

TAGS: BDIS, EGEN, EMIN, OVIP, PE

SUBJECT: CURRENT STATUS OF MARCONA - GOP HARDENS ITS

CONDITIONS - PROSPECTS FOR SATISFACTORY

SETTLEMENT DIM

REF: LIMA 3520, SHLAUDERMAN-MURDY-FURTH MEMCON OF

MARCH 20, 1975

1. SUMMARY: EMBASSY OFFICERS MET AT THEIR REQUEST WITH DR. ENRIQUE EAST, MANAGING DIRECTOR OF MARCONA MINING COMPANY, ON APRIL 30. EAST REVIEWED GROWING PRESSURE BEING PLACED ON MARCONA BY GOP IN APPARENT EFFORT EITHER TO SOFTEN MARCONA UP PRIOR TO EXPROPRIATION NEGOTIATIONS, OR PERHAPS EVEN TO CONSTRUCT" JUSTIFICATION" FOR SEIZURE OF MARCONA WITHOUT COMPENSATION. MOST OMINOUS DEVELOPMENTS OVER PAST SEVERAL WEEKS HAVE BEEN FINDINGS BY VARIOUS GOP ENTITIES THAT FINANCIAL PRACTICES FOLLOWED BY MARCONA HAVE BEEN IMPROPER OR THAT MARCONA'S TAXES HAVE BEEN INCORRECTLY CALCULATED AND THAT, AS A RESULT, MARCONA OWES GOP BETTER THAN \$37 MILLION. MORE RECENTLY, CONFIDENTIAL

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MARCONA HAS BEEN THE TARGET OF A VICIOUS PRESS CAMPAIGN

(FOR THE MOST PART IN GOP-OWNED "LA CRONICA") CHARGING MARCONA WITH EVERYTHING FROM POLLUTION TO CHEATING ITS WORKERS (REFTTEL) AND GIVING HEAVY PLAY TO CHARGES BY MINING COMMUNITY THAT MARCONA OWES GOP MONEY AND SHOULD BE EXPROPRIATED WITHOUT COMPENSATION. REPEATED PUBLIC BLUSTERING BY MINES MINISTER FERNANDEZ MALDONADO TO EFFECT THAT, COME WHAT MAY, MARCONA WILL BE NATIONALIZED, HAS SERVED AS LEITMOTIC TO THIS CAMPAIGN.

2. FOREGOING HAS BEEN TAKING PLACE AGAINST BACKGROUND OF PRELIMINARIES TO THE FORTHCOMING NEGOTIATIONS WHICH WILL ACTUALLY DETERMINE MARCONA'S FATE. A NEGOTIATING COMMISSION WAS FORMED SOME MONTHS AGO, BUT HAS SO FAR SHOWN LITTLE ZEAL, MEETING WITH MARCONA ONLY FIVE TIMES AND THEN ONLY FOR THE PURPOSE OF COLLECTING INFORMATION. HOWEVER, EAST SAID HE UNDERSTOOD THAT MINES MINISTER WOULD PRESENT MARCONA'S BUY-OUT PROPOSAL AT CABINET MEETING ON MAY 6. (NOTE: IN ESSENCE, MARCONA HAS PROPOSED THAT IT TURN OVER ASSETS TO GOP, CONTINUE TO OPERATE MINE UNDER MANAGEMENT CONTRACT, ARRANGE WITH JAPANESE TO INSTALL ADDITIONAL PELLET PLANT, AND TAKE PAYMENT IN PELLETS AT RATE OF 1.4 MILLION TONS PER YEAR FOR TEN YEARS.) ATMOSPHERICS ARE NOT PARTICULARLY GOOD. DR. JOSE LUIS BROUSSET (EX-VICE MINISTER OF ECONOMY AND FINANCE AND A MEMBER OF THE MARCONA COMMISSION, ALTHOUGH HE HAS YET TO ATTEND A MEETING) RECENTLY TOLD THE AMBASSADOR THAT HE DID NOT SEE WHY GOP SHOULD PAY MONEY TO ACQUIRE ASSETS OF A FIRM WHICH IS LOSING MONEY. FURTHER, WE UNDERSTAND ON GOOD AUTHORITY THAT FERNANDEZ MALDONADO BELIEVES THAT IN MARCONA HE HAS A MAJOR PROBLEM ON HIS HANDS WHICH MUST BE SOLVED WITHOUT DELAY, MORE PARTICULARLY SINCE MARCONA OWES GOP SUBSTANTIAL SUMS OF MONEY.

3. FOREGOING DOES NOT AUGUR WELL FOR FAVORABLE SETTLEMENT AND WITH PASSAGE OF TIME IT APPEARS INCREASINGLY LIKELY THAT GOP HAS TRUMPED UP FINANCIAL CLAIMS FOR MORE SINISTER PURPOSES THAN MERELY TO SERVE AS EXTRA BARGAINING COUNTERS IN NEGOTIATIONS. EAST SAID THAT MOST SERIOUS CLAIM, AN EFFORT BY MINISTRY OF COMMERCE TO DISALLOW FOUR PERCENT SALES COMMISSIONS, IS IN HANDS

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OF MINISTER OF COMMERCE ARIAS HIMSELF. ARIAS WILL BE IN WASHINGTON MAY 20-23 (LIMA 3302, 3241), AND EMBASSY STRONGLY RECOMMENDS THAT MARCONA SITUATION BE THOROUGHLY DISCUSSED WITH HIM BY ASSISTANT SECRETARY ROGERS AND SECRETARY OF COMMERCE MORTON. END SUMMARY.

4. GOP HAS TRUMPED UP FINANCIAL CLAIM AGAINST MARCONA TOTALING \$21 MILLION ON GROUND THAT FOUR PERCENT

SALES COMMISSION IS ILLEGAL.

A. EAST SAID THAT MOST SERIOUS PROBLEM WAS GOP EFFORT TO DISALLOW FOUR PERCENT SALES COMMISSION PAID BY MARCONA TO ITS SISTER CORPORATION, MARCONA INTERNATIONAL OF PANAMA (FORMERLY SAN JUAN, S.A.). THIS COMMISSION IS PAYABLE TO SAN JUAN UNDER TERMS OF LONG STANDING CONTRACT APPROVED BY MARCONA, THE SANTA CORP. AND THE GOP AND HAS BEEN PAID REGULARLY SINCE THAT TIME.

IN 1971 DECREE LAW WAS PASSED LIMITING SUCH COMMISSIONS TO TWO PERCENT. THEN, IN JANUARY 1975, THE DIRECTOR OF FOREIGN COMMERCE IN THE MINISTRY OF COMMERCE, ING. PASANO, SUDDENLY ISSUED A MINISTERIAL RESOLUTION CLAIMING THAT THE FOUR PERCENT COMMISSION ON EXPORTS DURING 1971-74 WAS NOT ALLOWABLE. THIS SUM WOULD TOTAL OVER \$21 MILLION WHICH, IF SUSTAINED BY A FINAL DECISION OF MINISTER ARIAS, WOULD IN THEORY HAVE TO BE RETURNED TO PERU. (EAST NOTED THE COMPANY WOULD NEVER ACCEDE TO SUCH A REQUEST.) EAST SAID THAT IN PART HIS CONCERN IN THIS MATTER IS BASED UPON FACT THAT ARIAS HIMSELF WILL MAKE THE FINAL DECISION, WITHOUT RECOURSE TO ANY OTHER AGENCY OR APPEAL PROCEDURE WHICH DOES APPLY IN CASE OF OTHER CLAIMS MENTIONED BELOW.

B. EAST SAID THAT PAYMENT OF FOUR PERCENT COMMISSION WAS COMPLETELY LEGAL. WHEN DECREE LAW WAS PASSED REGULATING SUCH COMMISSIONS, IT PROVIDED THAT IT WAS UP TO GOP TO TAKE INITIATIVE TO CHANGE CONTRACTS SUCH AS MARCONA'S WHICH PREDATED DECREE LAW. GOP HAS NEVER TAKEN THIS ACTION. WHEN THIS FACT WAS POINTED OUT TO MINISTRY, IT CAUSED CONSIDERABLE CONSTERNATION. ARIAS HAS NOW ASKED OTHER MINISTERIAL OFFICIALS TO STUDY THIS  
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ISSUE, AND HAS TAKEN ALL RELEVANT DOCUMENTATION WITH HIM ON HIS TRIP SINCE HE ANTICIPATES THAT SUBJECT MAY COME UP IN TALKS WITH USG OFFICIALS DURING HIS STAY IN WASHINGTON. EAST SAID HE EXPECTS NO DECISION ON THIS PROBLEM UNTIL ARIAS' RETURN IN LATE MAY. HE FURTHER AGREED WITH EMBASSY OFFICERS' SUGGESTION THAT A MARCONA PRIOR TO ARIAS' ARRIVAL. HE WILL RECOMMEND TO SAN FRANCISCO HEADQUARTERS THAT V.P. GORDON FURTH GO TO WASHINGTON. FURTH WILL CONTACT DEPARTMENT DIRECTLY.

5. THE TAX OFFICE OF THE MINISTRY OF ECONOMY AND FINANCE HAS NOW LEVIED FIVE SEPARATE CHARGES AGAINST THE COMPANY, TO WIT:

A. TAX DUE ON FOUR PERCENT COMMISSIONS. THE TAX

AUDITORS HAVE TENTATIVELY DECIDED THAT THE \$21 MILLION DUE TO THE GOP FROM THE ALLEGEDLY IRREGULAR COMMISSION PAYMENTS IS "NONDEDUCTIBLE INCOME" AND HENCE SUBJECT TO TAX:

B. TAX ON FREIGHT. THE GOP LEVIES A THREE PERCENT TAX ON THE COST OF OUTGOING OCEAN FREIGHT. NO ATTEMPT HAS PREVIOUSLY BEEN MADE BY GOP TO HAVE MARCONA PAY THIS TAX. TAX AUDITORS HAVE NOW LEVIED CHARGE ON ALL FREIGHT FOR PERIOD 1970-73, WHICH WOULD AMOUNT TO CLAIM OF \$16 MILLION. EAST SAID THIS DECISION IS PATENTLY ABSURD SINCE MARCONA MAKES ALL ITS SHIPMENTS FOB AND THEREFORE DOES NOT INCUR FREIGHT COSTS ITSELF.

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C. DISALLOWANCE OF BONUSES TO FOREIGN EMPLOYEES. TAX AUDITORS HAVE ALSO SUDDENLY DISALLOWED PAYMENT OF JULY (INDEPENDENCE DAY) AND CHRISTMAS BONUSES TO FOREIGN EMPLOYEES. (AUDITORS HAVE NOT QUESTIONED PAYMENT OF SAME BONUSES TO PERUVIAN EMPLOYEES.) THIS MATTER IS FURTHER COMPLICATED BY FACT THAT ALL EMPLOYEES HAVE ALREADY PAID TAXES ON THIS INCOME.

D. DISALLOWANCE OF DEMURRAGE CHARGES. FURTHER, AUTHORITIES HAVE CHARGED THAT DEMURRAGE PAYMENTS MADE

BY THE COMPANY HAVE BEEN TOO HIGH AND ARE UNACCEPTABLE. EAST POINTED OUT THAT THESE CHARGES ARE IN FACT LESS THAN THOSE OF OTHER PERUVIAN PORTS, INCLUDING CALLAO.

E. 2.5 PERCENT COMMISSION ON MAIN OFFICE PURCHASES. FINALLY, THE TAX OFFICE MAINTAINS THAT MARCONA'S TRADITIONAL 2.5 PERCENT COMMISSION PAID TO THE SAN FRANCISCO OFFICE FOR PURCHASES MADE BY THAT OFFICE IS NOT ACCEPTABLE. EAST POINTED OUT THAT THIS PRACTICE HAS BEEN GOING ON FOR YEARS AND HAS NEVER BEFORE BEEN QUESTIONED.

6. EAST NOTED THAT THE TAX OFFICE CHARGES, WHILE SERIOUS, CONFIDENTIAL

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DO NOT HAVE THE SAME URGENCY AS THE COMMERCE MINISTRY COMMISSION RATE ISSUE, SINCE MARCONA CAN APPEAL TAX OFFICE DECISIONS TO VARIOUS LEVELS, A PROCESS WHICH COULD TAKE SEVERAL MONTHS.

7. EAST SAID THAT MINES MINISTER FERNANDEZ MALDONADO WAS UPSET WHEN DETAILS OF MARCONA'S PROPOSAL WERE LEAKED TO THE PRESS (SEE LIMA REFTTEL) SINCE THIS ACTION WILL REDUCE HIS ROOM FOR FLEXIBILITY (ALWAYS PRESUMING HE WISHES TO BE FLEXIBLE). EAST SAID HE HAD LEARNED IN CONFIDENCE THAT THE MINISTER PLANS TO PRESENT MARCONA'S CASE TO THE CABINET MAY 6 IN ORDER TO OBTAIN FURTHER INSTRUCTIONS. THESE MIGHT INCLUDE A REQUEST FOR MARCONA TO MEET WITH THE NEGOTIATING COMMISSION TO BEGIN ACTUAL NEGOTIATIONS OR MIGHT MERELY AUTHORIZE THE MINISTER TO SET UP A SPECIAL THREE-MAN "EXECUTIVE COMMISSION" TO FURTHER STUDY THE MARCONA PROBLEM WITHIN THE MINISTER OF ENERGY AND MINES. EAST SAID THIS LATTER COMMISSION MIGHT BE HEADED BY ARMY GENERAL OF DIVISION (RET.) JORGE GOMEZ BECERRA AND WOULD INCLUDE TWO OTHER KNOWLEDGEABLE MINING OFFICIALS IN CONTRADISTINCTION TO THE WOEFULLY UNPREPARED MEMBERS OF THE NEGOTIATING COMMISSION.

8. EAST SAID THAT THE VITRIOLIC PRESS ATTACK AGAINST MARCONA IS BEING ORCHESTRATED BY THE HEAD OF OCI, GENERAL SEGURA. HE SAID THAT MARCONA'S BUY-OUT PROPOSAL, WHICH HAD BEEN PRESENTED TO THE GOP COMMISSION AND TO THE MINISTRY OF ENERGY AND MINES, WAS LEAKED TO THE PRESS THROUGH THE MINING COMMUNITY REPRESENTATIVE ON THE BOARD OF DIRECTORS OF MARCONA.

9. EAST TALKED TO PRIME MINISTER MORALES BERMUDEZ THREE WEEKS AGO, BEFORE THE PRESS CAMPAIGN BEGAN, AND RECEIVED MILD WORDS OF ENCOURAGEMENT. THE PRIME MINISTER NOTED THAT MARCONA HAS A GOOD REPUTATION, INVESTED IN

PERU IN GOOD FAITH AND THAT THE GOP WAS STUDYING MARCONA PROPOSAL. HOWEVER, HE REMINDED EAST OF THE PLAN INCA AND THE FACT THAT LARGE MINING PROPERTIES MUST EVENTUALLY REVERT TO THE STATE, BUT SAID HE FORESAW A MUTUALLY SATISFACTORY SETTLEMENT. EAST HAS THE IMPRESSION THAT MOREALES BERMUDEZ WILL FOLLOW THIS AFFAIR CLOSELY, BUT WILL NOT  
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INTERVENE DIRECTLY SHOULD THE RADICALS DECIDE TO EXPROPRIATE WITHOUT COMPENSATION BECAUSE OF HIS PRESENT DELICATE POSITION. EAST SAID MARCONA COULD NOT THEREFORE COUNT ON THE MODERATING INFLUENCE OF THE PRIME MINISTER, ALTHOUGH THE LATTER FULLY REALIZES THAT ANOTHER MAJOR EXPROPRIATION CONTROVERSY COULD HARM PERU'S FOREIGN CREDIT RATING AND ACCESS TO SUCH CREDIT, NOT TO MENTION U.S.-PERUVIAN BILATERAL RELATIONS.

10. EAST SAID THE COMPANY MANAGEMENT HAS DECIDED FOR THE PRESENT NOT TO COUNTER THE GOP-ORCHESTRATED PRESS ATTACKS WHICH WOULD ONLY HARDEN THE GOP POSITION AND HE HAS, IN FACT, MERELY ANSWERED "NO COMMENT" WHEN QUESTIONED BY LOCAL JOURNALISTS. HE SAID MARCONA HAS A GOOD RECORD AND SHOWED EMBASSY OFFICERS PROFIT AND LOSS STATEMENTS DURING LAST FOUR YEARS WHICH DEMONSTRATE THAT THE COMPANY PAID BETWEEN \$8 AND \$13 MILLION ANNUALLY IN TAXES DURING THIS PERIOD, EVEN THOUGH THE COMPANY LOST MONEY IN THREE OF THE FOUR YEARS.

11. COMMENT: IT IS CLEAR THAT MARCONA'S BARGAINING POSITION HAS DETERIORATED SERIOUSLY SINCE THE FIRST OF THE YEAR. IN ADDITION TO THE PROBLEMS DESCRIBED ABOVE, AT LEAST ONE OF THE TWO KEY TRUMP CARDS MARCONA HELD IN THE PAST HAS DISAPPEARED SINCE THERE ARE NOW PLENTY OF SHIPS AVAILABLE TO CARRY MARCONA'S ORE (SEE REFERENCED MEMCON), AND IT IS ALSO NO LONGER CLEAR WHETHER THE JAPANESE ARE STILL BEHIND MARCONA, OR INDEED ARE EITHER WILLING OR ABLE TO PROVIDE MAJOR FINANCING AT THIS TIME. (NOTE: THE DEPARTMENT WILL RECALL THAT THE JAPANESE HAD EXPRESSED WILLINGNESS TO FINANCE THE EXPANSION OF THE PELLET PLANT ONLY ON CONDITION THAT MARCONA REMAIN AS MANAGER OF THE FACILITIES. WE ARE NOT SURE WHETHER THIS CONDITION STILL STANDS.)

12. WE ESTIMATE THAT IN THE FIRST INSTANCE THE GOP WILL FURTHER STUDY THE PROBLEM AND PROBABLY AGREE AT SOME POINT TO SIT DOWN WITH MARCONA AT LEAST ON THE PRETEXT OF ATTEMPTING TO NEGOTIATE A SOLUTION. WE PRESUME THAT THE GOP HAS NOT YET DECIDED TO SEIZE MARCONA OUTRIGHT AND IN THE FIRST INSTANCE ORCHESTRATED BOTH THE  
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PRESS CMAPAIGN AND THE CHARGES OF FINANCIAL IRRUGULARITY  
PRIMARILY TO INCREASE BARGAAINING LEVERAGE AGAINST  
THE COMPANY. HOWEVER, WE NOW FEAR THAT THE FINANCIAL  
CLAIMS MAY EVENTUALLY SERVE THE MORE SINISTER PURPOSE OF  
PROVIDING THE GOP WITH A PRETEXT FOR SEIZING MACONA  
WITHOUT PAYING COMPENSATION. THERE ARE, OF COURSE,  
SOME RESTRAINTS AGAINST SUCH A MOVE, NOT ONLY IN REGARD  
TO THE CONSEQUENCES IN TERMS OF U.S.-PERUVIA BILATERAL  
RELATIONS, BUT ALSO, FROM THE PERUVIAN POINT OF VIEW,  
THE FACT THAT SUCH AN ACTION COULD LEAD TO A MAJOR  
RECONSIDERATION BY THE INTERNATIONAL BANKS OF THEIR  
INTEREST IN PRUVIAN MINING VENTURES AND OVER-ALL LOANS  
TO PERU. HOWEVER, THESE CONSIDERATIONS HAVE NOT SERVED  
AS MAJOR CONSTRAINTS IN THE PAST.

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